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No. 88-646

In The

Supreme Court of the United States

October Term, 1988

FIRST INTERSTATE CREDIT ALLIANCE, INC.,

Petitioner,

vs.

AMERICAN BANK OF MARTIN COUNTY, DOUGLASS E. WENDEL,

Respondents.

RESPONSE TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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STATEMENT

American Bank of Martin County for the most part agrees with the statement of the case as set forth by petitioner with several exceptions. The first exception relates to the delivery of the certificate of deposit. The delivery of the certificate of deposit six days after the execution of the promissory note was contemplated in the original transaction.

The second exception is to the statement made in footnote numbered 2. The bankruptcy court's finding that Leasing Service Corporation ("LSC"), was "grossly undersecured" was based upon findings that Air Conditioning, Inc.'s ("ACI's"), personal property was heavily liened with claims superior to LSC's lien and all of debtor's interest in its tangible personal property was sold by the trustee on February 21, 1985 for $1,000. Accordingly, ACI's belief as to the value of its assets was immaterial and no part of the bankruptcy judge's findings of fact.

Respondent also takes exception to Petitioner's statement that the bankruptcy court's findings were without a trial. Although a trial, as such, was not held, the parties stipulated to the essential facts, and the hearings were held without objection by the petitioner.

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ARGUMENT FOR DENYING THE PETITION

Respondent does not argue with petitioner's discussion of the law with respect to the independence and the inviolability of letters of credits. However, petitioner's

argument that in re: *Compton Corp.*, 831 F.2d 586 (5th Cir. 1987), violates the independence rule of letters of credit is not borne out by a careful examination of that opinion. The Court in that case recognized the sanctity of the letter of credit in the normal transaction for which it was designed, namely to secure the payment to a provider of goods and services. It is the risk of insolvency of the debtor in a sales-letter of credit transaction and not the risk of a preference attack that a bank assumes, according to the Court in Compton. The attack in the Compton case correctly was upon the preference granted the creditor through its receipt of an increased security interest in the debtor's assets. As in the instant case, the letter of credit was issued to back up an antecedent unsecured debt which was already in jeopardy. The Court distinguished those cases in which contemporaneous new value is given for the letter of credit from cases such as the instant one in which the letter of credit was issued for an antecedent unsecured debt. In the former cases no preferential treatment under 11 U.S.C. Sec. 547(b) is created. In the latter cases, the 5th Circuit Court of Appeals held that the Creditor-beneficiary of the letter of credit had received an indirect preference and allowed the trustee to recover the payment which had been made to the creditor. The sanctity of the letter of credit thus was upheld by the Court. It is interesting to note that the 5th Circuit Court of Appeals referred to the decision of the Bankruptcy Court in re: Air Conditioning, Inc. of Stuart observing that the same conclusion was reached.

The spector of the resurrection of in re: Twist Cap, Inc. raised by Petitioner is equally unfounded. In Twist Cap, a bank issued letters of credit in favor of two un-

secured creditors of debtor, secured by collateral of the debtor. The issuance of the letter of credit and the collateral transfer took place more than four months prior to filing of the bankruptcy petition. The transactions should have been immune from preference attack. However, the Court failed to recognize that the security had been furnished when the letter of credit had been issued and not when the creditor demanded payment and declared preferential treatment of the two creditors. Twist Cap has been unanimously repudiated and it is now clear that there is no risk of a preference to the creditor in the bulk of letter of credit transactions where the bank issues a letter of credit prior to or contemporaneously with the credit extension.

The repudiation of Twist Cap, however, left unanswered, until Compton and Air Conditioning, the question of who bears the risk of a preference attack when a secured letter of credit is issued for an antecedent debt and a bankruptcy case is filed on or within the 90 days specified in 11 U.S.C. Sec. 547(b).

The Bankruptcy Court, the District Court and two Courts of Appeal in answering the question have all held that the creditor-beneficiary should bear the risk of a preference being declared pursuant to the Bankruptcy Code. These decisions create far less risk to the banking industry than Petitioner's scenario raises. Under these decisions, the creditor is deprived of the benefit of the letter of credit, but the risk is not shifted to the bank and it is allowed to retain its security. To rule otherwise would cause banks in issuing letters of credit to assume the preference risk and give up its collateral to a trustee

in bankruptcy. This would create an impossible burden upon the banking industry to investigate the timing of the creation of the debt. The decisions of the lower appellate courts in this case do not have the disastrous effect on the banking industry suggested by Petitioner. When considered under the facts of this case, the risk is placed where it properly should be, on the creditor, whose position is already in jeopardy, and not the bank, which should be entitled to its security for the new value which it has issued in the form of a letter of credit. To rule otherwise would allow the undersecured or unsecured creditor to receive the benefit of the debtor's certificate of deposit and thus avoid the preferential transfer situation contemplated by 11 U.S.C. Sec. 547. This section of the bankruptcy code would thus be nullified as creditors in the position of LSC could indirectly extract payment from a debtor with impunity for the preference provisions of Sec. 547. This is a situation which Congress did not contemplate in enacting the preference provisions of the bankruptcy code. A creditor should not be permitted to do indirectly what it can clearly not do directly and pass the risk on to the bank issuing the letter of credit for the benefit of the creditor.

Petitioner in analogizing the beneficiary of a letter of credit to the beneficiary of a guaranty and the cases cited in support thereof fails to distinguish between the creditor who has given new value and the unsecured creditor receiving a guaranty for an antecedent debt. The rule in the instant case is a mere extension of the well established rule in guaranty situations. In *Aulick v. Largent*, 295 F.2d 41 (4th Cir. 1961), the Fourth Circuit Court of Ap-

peals, in a factual situation analogously similar to Air Conditioning, a debtor transferred collateral within the preference period to a third party guarantor to induce the guarantee of an unsecured antecedent debt. The guarantee and receipt of the collateral were contemporaneous. The Courts found that the guarantor had not received a preference and the Court fixed the preference liability on the unsecured creditor, the beneficiary of the guarantee.

The rule in Air Conditioning imposes the same result as in the above cited guarantee case. Air Conditioning correctly blends letter of credit law and bankruptcy preference law. It does not in any way affect the commercial letter of credit which makes up the bulk of transactions, but only affects the rare case where an unsecured creditor holding an antecedent debt attempts to improve himself with a letter of credit secured by debtor's property at the expense of other unsecured creditors.

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